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AMERICAN BUSINESS AND FINANCE AFTER THE WAR

Efforts to predict the economic future have usually been unsuccessful, since they require a knowledge of too many factors to permit of accurate forecasts. Few persons could have anticipated even the chief results of the present European conflict, either from the financial, the industrial, or the commercial standpoint. It is not likely that the later history and after-effects of the struggle will be easier to describe with accuracy than the events which have marked the progress of the war thus far. Nevertheless, it is true that definite consequences have already been produced, and that new conditions have been brought into existence since the conflict opened. The working out of these conditions must proceed along fixed lines. It is practicable at least to indicate certain alternatives of the future with a degree of certainty. The consequences of the changes already produced in American business and finance must be developed in directions which are already clearly defined; and although they may diverge from one another in ways which cannot now be foreseen, it is probably feasible to indicate why, and under what conditions such divergence will occur, if at all. Subject to these limitations, we may reasonably attempt to show some of the principal consequences likely to follow from the war, and some of the problems likely to be presented for solution at its close.

I

Without attempting even an outline of the chief financial features of the European war, certain economic aspects of it must necessarily be borne in mind in considering its consequences. Perhaps the most striking development of all has been the great alteration in international commercial and financial relationships. As affecting the United States, two features of this change require particular notice—the enormous growth in our export trade, and the fact that as a result of it we have succeeded in paying off a

considerable portion of the international indebtedness which we were carrying before the conflict opened. Precisely how great a trade balance has been developed by the United States since the beginning of the war it would be impossible to say with accuracy. A few salient figures are known, but beyond these, in spite of the constant more or less conjectural assertions, very little can be stated with certainty. It is reasonably assured that during the year 1915 there accrued to the United States a merchandise balance of about \$1,750,000,000, while during the same period there was a net gain of gold, through importation, of approximately \$400,000,000. It is probable that during that part of the war prior to January 1, 1915, we paid off, through excess of exported over imported merchandise, a current balance due to Europe amounting to from \$450,000,000 to \$500,000,000. During the year 1915, we furnished Europe, besides the Anglo-French loan of \$500,000,000, about \$300,000,000 in addition, upon bonds or bankers' acceptances, and it is probably true that during the same year (1915) we received back from foreign countries somewhere from \$1,000,000,000 to \$1,500,000,000 worth of our own securities formerly held abroad. Precisely what became of these securities to whom they were turned over, how far they went toward canceling indebtedness, how far they were used to sustain new credits at banks, as well as many other elements important in analyzing the financial problem of the year, cannot as yet be stated, and to attempt to state them definitely would be only misleading. We can at least say with certainty that, as a result of the year's operations, we definitely and finally paid off a considerable amount of our obligations, while foreign nations established with us corresponding credits, payment being made in our own goods of all kinds, shipped to buyers in other countries. The effect of these changes has been to place the United States in a definitely new financial position in respect to such foreign countries. At the close of the war, while we shall not be completely out of debt to other countries, we may safely expect that our debt to them will have been very much reduced, and that in consequence the necessity of making interest payments through excesses of exports over imports will be far less than at the beginning of the war, while

foreign countries will at the same time have acquired the habit of financing themselves to some considerable extent in the United States.

The banking changes resulting from the war have been even more striking than those of a purely financial nature. Prior to the beginning of the year 1914, foreigners engaged in exporting and importing business with the United States seldom thought of securing their banking accommodations in this country. The Brazilian coffee exporter, for example, who shipped his product to New York, required the New York importer to arrange payment through a London banking institution, so that drafts drawn upon the latter would be readily discounted when presented to a local banker at Rio. The exporter from the United States who sent cotton to Liverpool expected to be paid through the medium of acceptances by, or of drafts upon, an English banking institution. The American importer of woolen goods, who found it necessary to pay for his invoice in Manchester did so by arranging through his own bank for an English credit. In a lesser degree, the same conditions existed in trade with Germany, France, and other countries. Where such countries were not in a position to finance the trade themselves, it was usually through British banks and British capital that international trade was provided with the banking basis it needed. American banks made loans, it is true, to persons engaged in foreign trade, but they made them upon the same basis as domestic loans—that is to say, as advances of funds for a stated period, protected by a stated security. The credit business based upon the movement of actual goods and eventually dependent upon the standing or credit of the buyers and sellers of such goods was only rudimentary with us.

Two reasons may be assigned for these conditions: the lack of suitable banking legislation, and the fact that American banks were so largely engaged, and found so profitable a field, in their domestic operations, as to consider it of relatively little importance to themselves to seek the business of financing foreign transactions. The first of these obstacles to the growth of foreign-trade financing in the United States had already been removed prior to the opening of the war by the passage of the Federal Reserve act,

and by the state legislation, apparently patterned after it, which was adopted in a number of commonwealths. As the result of this legislation, both national and state, the power was given to American banking institutions to use their credit in accepting bills presented to them for the financing of export movements. On the other hand, with the growth and increasing significance of the economic changes due to the war, the financing of foreign business became not only profitable, but absolutely necessary to the welfare of American trade and manufacture. The fact that commercial-paper rates rose so very greatly in foreign countries, while at the same time they were so greatly reduced in the United States, owing to the release of reserves under the Federal Reserve act as well as to other conditions closely connected therewith, gave American banks not only a great competitive advantage, but also a position of greater profit and opportunity in the foreign trade than they could have acquired under other circumstances. The result has been a gradual development of the acceptance business by both national and state institutions, until today it is roughly estimated that perhaps \$150,000,000 of paper growing out of foreign trade has been accepted by American banking houses. It is true that thus far only some twenty-five institutions have secured from the Federal Reserve Board permission to accept bills up to 100 per cent of their capital and surplus (the limit set by law), but it is also true that many other institutions, without making such application, have begun to accept bills. It will be a matter of only a short time before the acceptance operations of national and state banks reach a level far higher than any thus far registered.

More important, however, than the acceptance business thus far, has been the development of ordinary credit operations between foreign countries and the United States, financed by American banking houses. Shippers in foreign countries, desirous of continuing or expanding their business with the United States, have secured the aid of American banks, and have opened accounts with the latter. In some cases, American banks have agreed to meet drafts drawn upon them, such drafts being protected in case of necessity by American securities held in trust, and simply hypothecated whenever conditions required it, in order to restore the balance of

the foreign drawers. In other cases, a credit has been established and maintained against warehouse receipts representing commodities stored in foreign countries, and ready for, or in process of, shipment to the United States, as circumstances demanded. Still other classes of accommodation have been arranged according to the convenience of foreign dealers and the facilities of American banking houses. The outcome has been that of transferring to the United States a considerable part of the actual work of "carrying" commodities in transit to and from this country—a burden formerly borne by banks in London and other European markets. A circumstance which has greatly aided in this process has been the increasing inability of foreign banks to continue to furnish the accommodations which exporters have been in the habit of receiving from them. Both English and continental institutions have found their resources severely strained by the new and unexpected demands growing out of the war. They have been unable to afford the facilities that they have supplied in the past, or to allow their branches in South America or the Orient to draw upon them as freely as heretofore, or even to furnish the funds actually in their possession at rates as reasonable as those that could be obtained from American banks. It would have been true, in any event, that, with our export trade so greatly increased, a natural tendency to the transfer of some of the banking operations attendant upon it to American banks might have been expected. This tendency, however, has been enormously accentuated by the increasing need felt by foreign and particularly British banks, due to the absorption of their means in other directions. The two elements working together have produced an exceptional growth of the business of foreign-trade financing on the part of American banks that could not otherwise have been expected.

A third element in the situation, likely to figure more and more importantly as time goes on, is found in the gradual evolution of foreign banking connections, either through the creation of branches or the establishment of agencies by American institutions. Only one large American institution has thus far taken advantage of the provision of the Federal Reserve act for the establishment of branches, but this one at least has done so upon a substantial

scale, which may be expected to show very definite results. However, the amendment of the Federal Reserve act in such a way as to permit the creation of jointly owned institutions intended for the establishment of foreign branches, will, when accomplished, do still more toward the further advancement of the branch system. In the meantime, somewhat similar results are being obtained through the working out of connections between American and foreign banking institutions. Not only the great private banks in foreign countries, but some of the government-controlled institutions—the central banks of Europe—have found it necessary or desirable to establish connections either with federal reserve banks or with the greater banks, national or state, of our principal cities. They have undertaken to do what has been either avoided or neglected in the past. They have placed accounts and opened credits with American banks, in order that they may thus hold more of the trade originating in their own countries, which would otherwise probably have gone direct to American banking houses. They have thus placed themselves under obligations to American banking houses, and have gained practical experience of American banking methods, in a way that would not otherwise have been possible, save under the slow influence of many years of gradual pressure. These foreign banking connections are likely to continue in effect upon some basis after the war is over, for reasons which will presently be noted. In the meantime, the fact of their existence places our bankers in a competitive position entirely different from that which they would have occupied had not conditions permitted the development of these connections.

Finally, it is worthy of special note that the creation of the federal reserve system has, beyond any question, transformed the American banking situation in its relation to foreign markets. For many years past, foreigners have looked upon the banking system of the United States as unstable and unsatisfactory. They have felt that the lack of a co-operative or centralized organization was an element of weakness, the effects of which might show themselves at any moment. They have found that, in times of panic or difficulty in the United States, American banks looked to them for aid, while in their own periods of difficulty they could expect

but little support from this continent. The federal reserve system has unmistakably tended strongly to correct this attitude abroad. Foreigners have shown marked interest in the system, an interest perhaps the more striking because of the fact that the new organization came at a time when European countries were deeply absorbed in their own affairs. It is believed by not a few capable and unbiased European financial authorities that the creation of the federal reserve system has radically altered the future relationship that may be expected to exist between European and American markets, rendering Europeans certain that a definite means of regulating rates of discount has at length been created, while rendering Americans less dependent, in consequence, upon European institutions, and correspondingly more able to regulate their own affairs in harmony with the changes in conditions at home and abroad. The maintenance of a more stable and uniform rate of discount, corresponding more clearly than ever in the past to the rates prevailing in foreign countries, must be borne in mind as one of the chief elements in the federal reserve system, and as one of the factors likely to be most influential in the gradual development of a true financial market in the United States. All of these elements in the situation may perhaps be summed up in the single statement that, partly as a result of our own changes in legislation, partly as a result of new conditions of exportation and importation, and partly in consequence of the altered financial outlook due to the European war, there has been established in the United States a genuine discount market, self-dependent, and in due measure self-controlling, concerning itself more and more with the financing of foreign trade, and, by so doing, developing the strength to maintain its own place in the management of such trade during future years.

II

The financial and banking effects of the European war upon the countries of Europe, as well as upon the nations whose trade is strictly dependent upon European markets, have been no less striking than those observable in the United States itself. The time has not yet come when definite statements can be made

regarding the actual position of the European banks; still less is it feasible at this time to forecast their approximate condition at the close of the war. A few general aspects of the situation may, however, be mentioned with some degree of confidence. There has been developed, in the belligerent countries of Europe, a paper currency not irredeemable, but in many cases verging so closely upon that condition as to be to all intents and purposes fiat money. The gold reserves of the European banks have not only been greatly reduced, relatively speaking, but are in fact in a far more hazardous condition than appears upon the surface. Export credit arrangements have in many cases been consummated upon a basis involving the later withdrawal of accounts from the vaults of the central banks with the sanction of the governmental authorities, who for the present are withholding such shipments, because of the bad effect they would produce were they to occur at once. This non-shipment of gold can be continued only in the event that exchange is provided either before or immediately after the end of the war, to an extent sufficient to furnish means of canceling the one- and two-year operations which have been effected upon a short-term basis. Great as has been the net gain of gold in the United States, it may be expected, therefore, that such gains will be still greater if there is no reason to look forward to an increase in productive power on the part of the belligerent nations, but rather to a decrease as the war continues, and consequently, to a falling off in their power to meet maturing obligations through the shipment of goods. The close of the war will almost certainly find the principal European banks not only weak in gold, but feeling a severe and continuous drain, largely toward the United States. Adoption of measures to stop this drain of gold, and if possible to turn the gold current in the opposite direction, must be looked to as one of the post-bellum developments in Europe. Apart from the changes in export trade which may bring this result to pass, European countries can control gold movements only by arranging with the United States for further loans or accommodations, which will enable them to retain their holdings or to acquire more. It may be reasonably assumed, therefore, that among the leading changes in European banking conditions due to the war will

perhaps be severe shortage of gold, with corresponding inability to increase loans, and an immediate necessity of negotiating with the United States or with other gold-holding countries for the return of the specie already taken from European nations, and held in excess of ordinary requirements. How far this backward movement of gold will be effected by what we may call "natural means," growing out of the movement of commodities, cannot be predicted with certainty; but the present prospects indicate a considerable use, at least for some time after the conclusion of the war, of direct loans, or a reliance upon negotiations designed to extend the maturity of loans already made. This phase of the European situation may be summed up as implying a continued decrease in power of accommodation to borrowers; a continued and increasing dependence upon the United States for gold with which to maintain the liquidity of foreign central banks; and a consequently continued development of the advantage of the United States in regard to the handling of current operations.

A second important view of the European banking situation at the close of the war grows out of the admitted fact that relations between European nations at the end of the struggle will probably be anything but friendly. Tariff warfare and commercial exclusiveness are now expected to be the order of the day as between the two groups of allied nations, and, while within these groups themselves there will undoubtedly be, if anything, an increase in the unity of purpose and community of interest which existed before the war, the power of mutual accommodation within these groups will, for reasons made evident, have been materially decreased. The fact that operations of a financial nature involving trade between the two groups of allies will be so greatly restricted is not merely based upon conjecture, but upon the fact that at the present time every effort is being made by each side to prevent the traders of the other from receiving banking accommodation. The extreme measures which are being prosecuted to this end, and which have been effective even as regards banking institutions of the United States and other neutral countries, may be expected to disappear after the war, but the feeling which has given rise to them will continue. In consequence, the striking aspect of the

post-bellum financial markets will be one of suspicion and interruption as far as Europe is concerned—a situation which will naturally tend to throw to the United States many operations which would otherwise never have been transferred here. A basis will thus be laid for the shifting of a considerable volume of business from Europe to the United States.

III

It is now worth while to sketch the position in which the United States will find itself at the close of the European war, so far as its banking and credit relationships are concerned. Assuming that present developments continue unchecked, there will be found to exist, at the close of the struggle, a very large addition to American banking operations, which has grown out of three conditions, as follows:

1. American exporters, finding new fields of business opened to them during the war, and finding foreign financial machinery inadequate, will have obtained accommodation from American banks, which will at the end of the war be sustaining an unusual volume of export transactions in this way.

2. Foreign banks situated in countries like Great Britain, France, and others, whose resources have been seriously reduced as a result of the war, will have come to lean more and more heavily upon American banking houses, opening credits with us, and expecting our bankers to finance shipments of goods in trade between the United States and these other countries.

3. Exporters and importers in countries dealing not only with the United States but with other nations (for example, exporters and importers in oriental countries who have been in the habit of dealing with European nations and financing their trade through London banks) will have transferred to American financial institutions an increasingly large share of the business of financing this export and import trade.

These three different sources of increased business will each have contributed its share to the upbuilding of a great volume of operations in the hands of American banks—a volume greater than has ever been possessed by these institutions in the past, and

greater than they could under any favorable circumstances have come to control had it not been for the unforeseen contingencies of the European war. The question as to how much of this business can be retained by American financial institutions under the conditions already set forth above is one of extreme interest and importance, and can be answered only by an analysis of the three differing sets of conditions already referred to. Before attempting such an analysis, however, it is worth while to know precisely how American banks are at present handling the great volume of new business which has fallen to their share.

The most striking phase, perhaps, of the new financial régime in the United States is found in the development of a definite discount market at those ports where the control of foreign business is most largely centralized. The market which in the past primarily occupied itself only with what was called commercial paper is now largely concerned with rates of foreign exchange, bankers' acceptance rates, and rates for the accommodation of foreign banking institutions. The most typical, perhaps, among these new developments has been the growth of the system of acceptances, the provision for which was made by the Federal Reserve act and by sundry state laws which followed its lead just in time to permit the use of this valuable agency in the handling of a wholly unexpected and unforeseen foreign-trade development. There are no reliable statistics with reference to acceptance credits in the United States today, but, from such figures as are available, it is safe to say that at this writing the total amount of acceptances does not very much exceed \$150,000,000. This is a small sum in comparison with the total amount of trade which is now being financed through American institutions, but which has a significance very far in excess of its actual volume. The existence of the acceptance system has been effective in establishing stable rates of interest for export credits, and in furnishing to foreign bankers a guide with respect to credit conditions in the United States, which would otherwise have been lacking. It may be expected that the acceptance business will greatly expand as its advantages become better known to American bankers and as the method of employing it becomes more and more widely recognized. The fact that under

the Federal Reserve act the total amount which may be accepted by a member bank is limited to 100 per cent of capital and surplus as a maximum, will prove a useful check upon what might otherwise, lacking the control exerted by custom and tradition in the English financial market, be carried too far. It is probably true that we shall not develop in the United States an acceptance mechanism exactly similar to that which has been worked out in England through the agency of the acceptance houses of that country, but it is also true that a substantial equivalent of the English acceptance market will be furnished through the federal reserve banks, whose extension will tend more and more to unify and keep stable not only the rates on acceptances, but the conditions under which they are actually granted by the banks themselves.

Another factor of large importance in the credit development at the present time has been found in the actual transfer of balances to New York and other points in the United States. Many foreign banks in different parts of the world, which in years past never found it necessary to keep an account with an American bank, are doing so now. They are sustaining these accounts in many cases by collateral loans, protected by American securities belonging to them, but held in trust by the American banks with which the credit has been opened. In other cases, they are simply transferring to the United States funds which in other years have been placed largely with London or Paris banking houses. American bankers are providing exporters of American goods who are shipping to these countries with cash in payment for their goods upon documents presented, deducting such payments from the accounts of the foreign banks, and looking to them for reimbursement either through transfers of funds from elsewhere, new loans protected in the way already described, or actual shipments of specie or the equivalent. The question of continuing this type of financial relationship is a complex one which will be referred to at greater length later; but at this point it is worthy of remark that foreign bankers are governed by custom in a far greater degree than are ours, and that the relations which they have once opened with the United States, if found satisfactory, will undoubtedly tend to be continued.

By the side of the new acceptance and export credits which have thus been described, there is being built up, thus far upon a small scale, a system of participation in foreign enterprises which is new to the United States, but which is likely to play an important part in the future developments which will follow immediately after the war. Foreign government loans have already been placed here in considerable amounts. The Anglo-French loan is of course familiar to all, but, in addition to purely war flotations, there has been also a very considerable development of loans based distinctly upon peace conditions. The floating of the Argentine bonds a year or two ago, the sale of various issues of short-term notes put on the market by European countries for the purpose of meeting their immediate necessities, and other operations of the same kind have been followed or accompanied by the taking up of a smaller quantity of foreign industrial securities, including some South American issues. It has long been a staple subject of observation that such participation in the sale of securities representing foreign enterprises is practically necessary if we expect to sell our goods on a large scale in the markets of those countries. Countries obliged to obtain from others the means of forwarding their material development are today almost invariably required to accept the proceeds of their loans in the form of goods rather than in that of free cash, and this condition will hold true when peace has been restored and international trade has again become normal.

Accepting these as perhaps the most striking features of change in the financial situation of the United States, we may now attempt an analysis of the elements in our business to which reference has already been made. Turning first to the question of trade between the United States and foreign belligerent countries, which is today being increasingly financed here, the prospects for the future are comparatively obvious. English banks have surrendered to the United States a share in the task of financing the export trade passing from this country to Great Britain, but only in part, and only under great pressure. After the close of the war, or as soon as circumstances will permit, they will undoubtedly make every effort to recover it. The question whether American bankers will succeed in holding the business which they have thus built up will, in the last analysis, depend upon the rates of interest or discount pre-

vailing in this country, as compared with those prevailing in London and other European markets. Our rates are today lower than anywhere else in the world, but what will they be after the close of the European war? No human being can make any authoritative prediction upon this score, but we may be permitted to indicate, at a later point, some of the factors which will tend to control this matter. The conditions will be such that Great Britain and her bankers, possessed of their past skill in international trade, possessed of the complete machinery for doing international business at a close figure, and eagerly desirous of recovering their profitable field for the employment of bank capital, will do what they can to reconquer the place from which they have been obliged for strategic reasons to withdraw during the continuance of European hostilities. They will not find American bankers as in the past unable to meet them with their own weapons, because the development of the acceptance system and the initiation of foreign business along other lines will have greatly strengthened the competitive power of this country. Even assuming, however, what is not likely, that American bankers will be able to meet English competitors upon an equal basis from the standpoint of method, the decisive factor in the case will, as already noted, be the rate of discount. As a modification of this statement, must be borne in mind the fact that the wishes and disposition of American exporters and importers will likewise have due influence. Should they show a decided disposition to secure the services of their own banking institutions in financing their foreign trade, instead of as in the past relying upon the services of British houses, a serious obstacle will have been interposed to the re-transfer of the business to the English banking institutions, which originally lost it to us through force of circumstances. In summary then it may be said that in this branch of business the future will depend largely upon the relative rates of discount for good foreign bills, and the conditions under which exportation and importation are controlled by those houses which are able to control the methods of financing shipments from this country.

A similar review of the second branch of the business—that representing trade between the United States and other countries which have heretofore been dependent upon foreign markets—may

likewise be undertaken. What will be the future, let us say, of the trade of Brazil with the United States? Will shipments of coffee to the United States be paid for in drafts on London institutions, or will they as at present be financed, at least in some measure, through New York banks? There is a new set of factors to be considered in connection with this question. As has been noted at another point, the development of foreign trade between, say, the United States and a country like Brazil is in no small degree dependent upon the readiness of American citizens to make long-term investments in Brazilian enterprises. Brazilian houses are today turning more and more to the United States for their credits, simply because they cannot get them as cheaply and satisfactorily in Europe. They are opening accounts with American banks, and they are being paid in drafts drawn on New York in dollars, instead of in drafts drawn on London in pounds sterling. When the war is over, and competition has been restored to somewhat its old basis, what will be the status of this type of business? Brazil will undoubtedly be influenced then, as in the past, by the extent to which British and other foreign houses stand ready to accommodate her in financing her long-term enterprises. If Americans are willing to do what England has done in the past, there is no reason why the United States should not retain for itself the new field of business which it has succeeded in opening not only in Brazil, but in other similarly situated countries. In this connection, much stress should also be placed upon the same question of financial convenience. An enterprising American institution has opened branches in Brazil and other South American countries. It has thereby greatly facilitated the transaction both of short-term and of long-term business between the two nations. This, however, is an example which has not been followed by other American banks, and it cannot be doubted that much of the future success of our bankers in holding the new business which is coming to them in undeveloped countries will depend upon their policy and willingness in furnishing convenient facilities for the direct transaction of such business in those countries. This is a matter which in the immediate future will undoubtedly mean success or failure. With respect to the effective development of the branch banking system, the willingness of

American bankers to enter this new field and to hazard the capital thereby required, has, as already stated, been slender. Should it continue slender, an important element in the control of the business for the future will undoubtedly have been lost. Assuming, however, that in sundry countries a more vigorous support may be shown, it is clear that a continuance of the business now coming to the United States will ultimately depend upon the rates of discount that can be offered by American institutions, as compared with those of foreign countries.

In the third field, to which reference has already been made, the situation is likewise dependent upon special and individual consideration. For example, will an exporter of goods from the Malay Peninsula to Great Britain, who now finances his dealings through the United States, be likely to continue so to do after the close of hostilities, and after the restoration of regular business relationships between Great Britain and other countries? It is certainly true that, in this field of business, the transfer of financial dealings to the United States has been made only under difficult conditions and most unwillingly. It is also true that in many countries, notably in the Orient, men engaged in foreign trade have found themselves either deprived of their usual European banking accommodation, or obliged to pay for it at so high a rate that they have ultimately preferred to go direct to the United States for the loans they have sought, rather than to obtain them through a British bank, which in effect transferred them to the United States. In this connection, one or two interesting commercial developments should be noted. In certain classes of trade, involving well-known Eastern products, London and other European cities have acted as distributing points for no good reason except that in the past custom has made these points the headquarters of the business. Incidentally, financial connections have been developed there, and the business, once started, has become definitely settled at those points. Thus, for instance, London was at one time the center of the hemp trade of the world, distributing that article to other nations, and even, it would appear, at times routing shipments from Manila through the Suez Canal to points of consumption in the United States, transportation rates being varied

to correspond. There would appear to be a tendency today to rearrange these more or less artificial conditions of international trade, and to shift the center of business, in some particulars at least, to the United States. Undoubtedly, again, the sugar trade of the world may be greatly affected by the war, and American prices may continue to be controlling factors to an extent not previously possible. Wherever this kind of industrial control is transferred to the United States for good and sufficient reasons, it will be possible for our bankers to hold the financing of the business provided they are able to meet foreign competition. Wherever, after the war is over, the older conditions of distribution and consumption are restored, it may be expected that the financing of the business will likewise slip back into its older channels. How far such restoration will be probable in various lines, it is not possible to assert with confidence. The fact that foreign countries, notably Great Britain, are in so strong a position of control with respect to transportation rates, will undoubtedly prove a severe handicap to the United States in holding the business. Another factor worthy of special note in this connection will be found in the extent to which the United States is able to build up, with such countries, a regular and stable export and import business. The oriental nations which have in the past looked to Great Britain and Germany for their financial resources have not done so primarily because of minor differences in discount rates, but because they were habituated to regular trade with those countries, while their trade with the United States was less regular and less well established. It is too much to expect that a country which is shipping goods to, say, Germany, and which does but little business with the United States directly, should do its financing in the United States. That would assume both a greater keenness of competition, and a more complete freedom from the dictates of creditor nations as to where purchases should be made, than probably exist, or can exist, in the future. If, however, the trade which Americans are now building up with such countries can be held and continued on a steady and normal basis, it will be fair to expect that our bankers may successfully retain their present position in financing the general export and import operations of such countries, or in

other words, that they will not be at once displaced by European bankers. This phase of the question evidently also depends, therefore, upon such general considerations as the rates of discount, and the nature and direction of the foreign trade which will exist after the war is over.

IV

From what has preceded, it will have been seen that, in addition to the special factors applicable to different branches of our foreign trade, there are certain elements which must be regarded as of a general or universal importance in determining the direction of post-bellum business. The most important of these, as already incidentally observed, is the extent of our export trade itself. In other words, what, at the close of the war, is to be the status of American foreign business? The importance of this question is recognized when we realize that the existence of a steady and active foreign trade is practically inevitable as a foundation for the establishment of a regular discount market, and that this foreign business must be of a diversified character, well distributed both as to the nature of the goods with which it deals and the countries to which it is sent. Fundamentally, therefore, some answer must be made to the question, What is to be the probable future of American exports?

There was a time immediately after the commencement of the European war, when it seemed as if there would be merely a mushroom growth in American export trade, involving first of all the shipment of great quantities of foodstuffs to meet the requirements of the belligerents, and consequently the shipment of great quantities of munitions of war for the same purpose. It was easy to see that a period would speedily follow when both of these classes of demand would disappear—that for foodstuffs because of the restoration of the usual channels of supply, and that for munitions because of the ultimate suspension of hostilities. A great change has been wrought in the situation by the gradual restoration of the sources of food supplies abroad, and by the development of the munition-producing capacity of the belligerent nations. Foodstuffs now play a relatively less important part than at first, and the overwhelming amount of

munitions exported, which for a time was characteristic of our foreign business, has now been cut to more normal proportions; yet the volume of exports has fallen off but little, and this because of the steady development of trade with neutral nations. Belligerents have more and more tended to economize in the purchase of foreign luxuries, and have tended more and more to produce their own supply of munitions. Neutral nations have consequently been unable to get from the belligerents the quantity and quality of goods which formerly came to them. They have therefore turned to the United States, and our exports to Canada, South America, and sundry oriental countries have greatly increased. Simultaneously with this condition has come about the gradual development of imports toward a sounder situation, and a rapid expansion of domestic demand, which has produced the general condition of prosperity now familiar in the United States. Altogether the export trade has developed satisfactorily, and on a far more stable and normal basis, giving promise of far greater soundness for the future than could have been predicted a year ago. Thus far, the prospects in this field are good. What will happen later is, however, another matter. It is evident that, after the war is over, we shall be faced by exactly the same problems of competition, in a large sense, as before. The question will be whether we can hold the general and diffused export trade which we shall have built up with a great number of foreign countries. To some extent, this question will be independent of prices, as in the case of American patented articles, sold at fixed prices throughout the world; but in the main the question of prices will be fundamental. In the meantime, we are working in the United States toward an unprecedentedly high cost of production. Prices are now higher for most staple articles than ever before; wages are certainly far higher. The only element in the cost of production which has been distinctly reduced is the charge for the use of short-term capital, which has been phenomenally low. Let this tendency to high cost continue, and we shall find it the greatest of all handicaps after the war is over. It need not be expected, as some seem to expect, that the depleted countries of Europe will immediately be able to send out a flood of very cheap goods, able

to expel American products from every part of the world. Neither is it true that cost of production in foreign countries will have failed to increase. The item of taxes alone will constitute a heavy handicap to the foreign producer. The existence of bad currency conditions in foreign countries, and the unfavorable rates of exchange, will likewise handicap those who wish to engage in active competition with the United States. Nevertheless, it is evidently true that we are today tending toward the establishment of a high level of prices, and a high domestic cost of production that must therefore seriously interfere with our retaining the foreign markets which have been forced upon us without any effort upon the part of our manufacturers. It will be for our producers to determine whether they can and will meet foreign competition, and so retain the field of operations with which they have been provided. If they will not arm themselves against foreign competition, they must expect a material decrease in their sales, resulting in a correspondingly large reduction in the extent to which they will be able to direct the financing of business through American institutions.

Another and equally large and important problem to be disposed of in this same connection is the question of capital. At the restoration of peace, will American markets be in a position to maintain their ascendancy in the supply of capital, as compared with foreign markets? At the present moment, they are notably superior in this respect. Will such superiority last? It may seem at first sight absurd to suppose that there could be a shortage of capital in the United States, corresponding to the shortage which will exist abroad, when the exhausted belligerents have laid down their arms; but a closer analysis shows that the idea is not as absurd as might appear at first sight. We may, for example, practically turn over our capital to foreigners. This has already been done in the case of the Anglo-French loan and other loans, which resulted in our transferring to belligerents actual control of a corresponding volume of fluid capital. We might have rendered an equal amount of relief by taking over from the would-be borrowers their financing of international trade, thereby enabling them to finance their own necessities for war; but this method at the time was too indirect, and too little understood to be adopted, while British bankers

would not of course have considered it favorably, except in the event that all other proposals had failed. Since the consummation of the Anglo-French loan there has, as we have seen, been a steady transfer of the burden of financing international trade to American banks. The fact nevertheless remains that we have taken up in the United States, not only the Anglo-French loan, but several hundred million dollars in other loans, and have in a corresponding degree transferred our available fluid capital to those who were responsible for issuing these loans. A continuance of this policy may result in still further reducing our holding of fluid capital at the end of the struggle. It is also possible that with the stimulus of high prices and prosperity, American business men may be led to overdevelop enterprises of doubtful productiveness. When the war is over, they may easily find themselves saddled with heavy fixed investments, which cannot, for many years, become productive. The mere fact that individual owners of such plants may have been compensated for their investments does not affect the situation greatly; for it remains true that the funds needed in establishing these enterprises have been definitely disposed of and diverted from any other economic use. It is entirely conceivable—indeed, some serious symptoms are already evident—that at the close of the war a considerable part of our capital may be tied up in fixed and non-available investments. To that extent, our capital-supplying power and the liquidity of our banks will have been decreased, and our capacity to keep the rate of discount low will have been reduced. To the extent that these factors are allowed to become operative, our competitive power will be lessened, and we shall be unable to meet, as we might otherwise have met, the competition of other nations.

If, in the meantime, we shall have remained content with the temporary prosperity now flooding the United States, and shall have failed to familiarize ourselves more thoroughly with the use of modern methods of financing international trade, through the skilful establishment of foreign connections—either branches of American banks, or well-fortified agents and correspondent institutions—we shall be still further hampered in our attempt to hold what we have. If, on the other hand, the tendencies to inflation,

now evident in so many quarters, can be checked, and if the steadily mounting cost of production evident in most lines can be curtailed, while rather more attention is paid to the improvement of banking and financial methods, we may expect to enter upon the struggle which will inevitably open at the close of the European war with good reason to expect success. The situation is really one that rests in our own hands, and calls for a decision as to how we shall employ our funds in the future, as well as with regard to the position we wish to occupy in the general world-community of banking and finance. Unfortunately, it is not possible to obtain a consensus of opinion on these points at any given time, and thereafter to enforce it by mere act of will, as the individual resolves upon the course which he himself determines to pursue. We can only point out certain lines of action which, if sustained, will assist in the attainment of the object referred to, and certain other lines the results of which will, with equal certainty, tend to defeat the objects so held in view.

V

What are the conditions and courses of action thus referred to which must be resolved upon by the bankers and financiers of the country if they desire to secure the pre-eminence of this country as a financial and banking center or market? First of all, as has been already suggested, is the necessity of maintaining a liquid, safe, and conservative position on the part of the banks. This involves a consideration of the status of the federal reserve system and its services. Undoubtedly, the low rates of discount which have prevailed throughout the United States have been in no small measure the result of the workings of the federal reserve system. This view is so generally admitted as to require little explanation or support. Undoubtedly also the release of reserves which has resulted from the inauguration of the federal reserve system, coupled with the low rates of return realized by many bankers upon their fluid funds, has led to an anxiety upon their part to invest amounts in ways that have not been wise, when considered from the standpoint of general banking policy. The better-informed bankers have been diverting their spare funds into the remunerative

field of foreign trade, but many of the smaller and less well-informed members of the banking community have tended frequently to the investment of their resources in long-term securities, and this tendency is still at work. It remains for the rank and file of American bankers to determine whether they are willing to conserve their strength against the inevitable moment of severe competition with foreign countries, when there will be demand for all the support that they can supply, and when the profits to be reaped will more than make up for temporary sacrifices made in the meantime. It would be entirely possible to inflate the credit structure of the country to such an extent, and to allow our available funds to become involved in such a way, as to lead directly to stringency when the conditions of world trade change, and correspondingly to impair the power of maintaining payments for the time being. If, at such a time, the federal reserve system were compelled to bear—as it would be—the whole burden of maintaining the fluidity of the banking system of the country, including non-member as well as member banks, its capacity for meeting demands and for stabilizing rates would be correspondingly reduced. No amount of gold which it might have accumulated would at such a time serve to offset the burdens which would be thrown upon it. To regard it as an emergency organization to be joined only upon the occasion of difficulty, by institutions which in the meantime may be chiefly engaged in inflating their own operations, would be to deprive the American banking community of the essential advantages of co-operation, and of the liquid condition growing out of that co-operation. As against such a policy may be considered that of proceeding in the effort to convert the paper of the country into liquid forms, developing so far as practicable the bill of exchange and trade acceptance, eliminating loans practically intended for capital purposes, and, under the leadership of the federal reserve banks, consolidating the banking resources of the country. It will thus be possible to develop a real discount market controlled by the operation of the reserve banks themselves, through their holding of a considerable quantity of bills to which they may add, or from which they may subtract, as circumstances require. The adoption of such a policy will find the banking community at the close of the

war in a position to present a united front in competing with the highly centralized systems of banking and finance existing in foreign countries, whose operations will undoubtedly be restored to their original effectiveness as soon as possible after the war is over. It is probably true that the pursuit of a policy such as that just outlined and involving the elimination of long-term loans, the converting of non-liquid forms of paper into liquid forms, and the general conservation of the liquid funds of the community, even at the cost of immediate profit, will entail a considerable temporary sacrifice of possible profit. It is, however, upon just such sacrifice that the maintenance and development of the banking and financial strength of the country will depend. It should be borne in mind that the close of the European war will present to the United States a situation and an opportunity perhaps never before known in economic history, but that the time during which this opportunity will continue to be presented will necessarily be short. The estimates of some capable economists suggest that, however great the destruction of capital during the war, the restoration of conditions of competition substantially similar to those which existed before the outbreak will, at most, be a matter of but a few years. It will be during that short period that the American financial community must demonstrate its capacity to avail itself of the new openings so unexpectedly placed before it, and to do so through the use of resources whose conservation is now clearly to be urged.

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